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James A. Carder
Director
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MEMORANDUM

TO: State Agencies
FROM: OA/Division of Accounting
DATE: March 22, 2004
RE: Recording Capital Leases on SAM II

During preparation of the FY 2003 Comprehensive Annual Financial Report (CAFR), problems regarding the proper recording of capital leases were identified. Some agencies are not recording leases in the general ledger or reporting the associated fixed asset in the fixed asset subsystem in accordance with the published policies and procedures.

The following significant problems areas have been identified and need to be addressed immediately:

- Not all capital lease obligations and associated assets have been recorded in SAM II. This causes both the general ledger and the fixed asset subsystem to be understated.
- A capital lease obligation has been recorded in the general ledger, but the corresponding fixed asset has not been entered into the fixed asset subsystem. This causes a reconciliation issue between the general ledger asset accounts and the fixed asset subsystem. This also impacts both the balance sheet and income statement, as depreciation is not being calculated and posted correctly.
- The fixed asset has been entered in the fixed asset subsystem, but the capital lease obligation has not been recorded in the general ledger. This also causes reconciliation issues between the fixed asset subsystem and the general ledger asset accounts.
- Capital lease payments are being made, but the capital lease object codes (2877-2909) have not been used and the appropriate balance sheet account has not been referenced. This causes the expenditure to be reported in the wrong category for financial reporting purposes and the system to close the payments incorrectly because the wrong account type is being used.

- Capital lease payments are made and a capital lease object code is used, but the balance sheet account 2540 has not been entered on the payment document. This causes the capital lease not to be liquidated when the payment is made, thereby overstating the liability and the system is not closing the payments correctly because the wrong account type is being used.

Please make sure that all journal vouchers are processed to load the capital lease obligation and capital asset to the balance sheet. If any lease payments have been made incorrectly during fiscal year 2004, please process journal vouchers to correct the payments. It is imperative that these journal vouchers be completed prior to the June 18 fiscal year end cut-off date. Summarized payment correction information on one journal voucher document with appropriate supporting documentation attached will be accepted. Agencies also need to make sure that the capital asset has been added to the fixed asset subsystem prior to the established cut-off date in June.

Detailed procedures for the proper treatment of capital leases have been attached for your convenience. If you need additional assistance, please refer to the full set of policies and procedures (the Capital Leases section) or contact the Office of Administration/Division of Accounting's Financial Reporting Unit. The email address is OASAMIFIXEDASSETS@oa.mo.gov or from within SAM II the User ID is OK104.

Finally, please send amortization schedules for all capital leases entered into during the current fiscal year and for any other leases not previously reported to OA/Division of Accounting by June 30, 2004.

Attachments:
Summarized capital lease procedures

Summarized Capital Lease Policies and Procedures:

Determine if the lease entered into is a capital lease or an operating lease. A capital lease has to meet at least **one** of the following criteria:

- a. At the end of the lease, the State owns the property.
- b. The lease contains an option to purchase the leased property at a bargain purchase price.
- c. The lease term is equal to or greater than 75% of the estimated economic life of the leased asset.
- d. The present value of the minimum lease payments is equal to or greater than 90% of the fair value of the asset.

Templates have been developed to aid in applying the above criteria. The templates and instructions for using them are available on the Internet. Go to the state web page (www.mo.gov), click on State Employees, under SAM II – click on Financial, click on Policies and Procedures, click on Financial Policies and Procedures, on the left click on the (+) next to Fixed Assets, click on the (+) next to Capital Leases, click on Capital Lease Templates. Please note, cells that should be manually input are in green, cells with formulas are in red.

If your lease is a capital lease:

1. Record the asset and liability with a Journal Voucher (JV) in the online general ledger. Record the asset and lease obligation at the “Total Cost” amount from the lease template.

Example – new equipment lease with no payments yet made:

DR: Equipment (BS Account 1709)	XXX	
CR: Obligation Under Lease (BS Acct 2540)		(XXX)

Example – old lease (prior fiscal year), payments have been made:

DR: Equipment (BS Account 1709)	XXX	
CR: Obligation Under Lease (BS Acct 2540)		(XXX)
(the outstanding principal at beginning of fiscal year)		
CR: Prior Yr Retained Earnings (BS Acct 3265)		(XXX)
(the difference between the asset and the liability)		

Note: Obligation Under Lease BS Acct 2540 is a liability account type 02 and Prior Year Retained Earnings is a fund balance account type 03.

2. Record a Fixed Asset Acquisition (FA) document in the fixed asset subsystem for the equipment making sure to use acquisition method “L” for leases.

When a payment is made:

When completing the payment document, a capital lease object code (2877-2892 and 2898-2909) **must** be used and balance sheet account 2540 – obligation under lease purchase **must** be entered.

Example – lease payment

DR: Expenditure (Acct Type 23)	XXX	
(object code must be 2877–2892 or 2898–2909 AND BS Acct 2540)		
DR: Interest Expense (object code 2853)	XXX	
CR: Cash		(XXX)

Each payment should be coded to principal and interest based on the lease amortization schedule prepared and submitted to OA/Division of Accounting.

Amortization templates are available on the Internet. If you need assistance, contact the Office of Administration/Division of Accounting's Financial Reporting Section.

When a lease is terminated:

If all lease payments have been made and the leased asset is no longer in State custody, a FD document must be processed to remove the asset from the fixed asset subsystem and the online general ledger. Notification of such termination should also be forwarded to the Office of Administration/Division of Accounting's Financial Reporting Section.

If a lease is renewed, the agency must re-evaluate the lease to determine if it still meets the criteria for a capital lease and make the appropriate corrections to the SAM II system as needed.